KENSINGTON ENERGY LTD.

1995 Annual Report

ANNUAL MEETING

The Annual and Special Meeting of Shareholders will be held at 3:00 p.m. on June 26, 1996 in the Lakeview Room of the Westin Hotel located at 320 Fourth Avenue SW, Calgary, Alberta.

Shareholders are encouraged to attend and those unable to do so are requested to complete and return the proxy form at their earliest convenience.

CORPORATE PROFILE

Kensington Energy Ltd. is an oil and gas exploration, development and production company with exploration activities concentrated in central Alberta. The Company was incorporated in January, 1995 and became active in March, 1995. In August, 1995, Kensington completed a $7,000,000 initial public offering. The Company's Class A Shares, Class B Shares and Warrants trade on The Alberta Stock Exchange under the trading symbols KNN.A, KNN.B and KNN.WT.A respectively.

HIGHLIGHTS

December 31	1995
Financial	
Working Capital	$4,813,928
Total Assets	$6,685,442
Capital Expenditures	$1,648,973
Shareholders' Equity	$6,161,139
Share Capital	
Class A Shares	
Outstanding	3,570,000
Class B Shares	
Outstanding	887,250
Reserved For Issue	736,750
Land Holdings	
Gross Acres	18,895
Net Acres	5,941
Drilling Activities	
Gross Wells	11.0
Net Wells	2.6

MESSAGE TO SHAREHOLDERS

We are pleased to present Kensington's first Annual Report for the period ending December 31, 1995. Subsequent to founding the Company in March, 1995, Kensington's management and board of directors established the following corporate goals for 1995:

- complete an initial public offering (IPO) of sufficient size to allow Kensington to carry out an active exploration program;
- participate with our joint venture partner, Westward Energy, in certain of its exploration prospects;
- establish core exploration areas through development of a prospect inventory and acquisition of a land base in these areas;
- drill sufficient oil and gas prospects in order to expend flow-through funds in a prudent manner;
- engage key employees and consultants to enable Kensington to compete effectively in its core areas.

The Company's achievements in relation to these goals were as follows:

- completed a $7 million IPO in August, 1995. Over 700 subscribers in six provinces participated in the offering. The net proceeds from this financing will allow the Company to participate in an active and extensive exploration program;
- participated with Westward in seven (1.38 net) wells on Westward-generated prospects in 1995, including three (0.13 net) wells at Grand Forks, resulting in two (0.10 net) oil wells;
- developed core exploration areas in south-central Alberta (Cherhill area). These core areas offer the following advantages for Kensington:

  - prolific oil and gas prospects occur at moderate (1200 to 1600 meter) depths
  - oil & gas potential exists in several zones
  - the areas are accessible year around and are close to infrastructure
  - significant new pool discoveries are possible with moderate costs, and
  - management has experience in these areas;
- renounced $1,856,162 of resource expenditures to our IPO subscribers amounting to 28.6% of the flow-through funds raised;
- attracted key personnel to our exploration team.

Kensington is now well positioned to participate in an active exploration program in 1996 - the capital, prospects and people are in place. Although we did participate in 11 wells (2.60 net wells) in 1995, only two of the wells drilled (0.80 net wells) were on Kensington-generated prospects. We look forward to drilling more of the Company's exploration ideas in 1996, particularly in our central Alberta core area. Currently we anticipate four to seven exploration wells being drilled on the Company's prospects over the summer months. Our approach to generating our own prospects which have significant upside potential for Kensington requires time to verify the technical components and build an adequate land position. This approach will, in our view, provide Kensington with the best growth opportunities in the long run.

Kensington's future success will largely be determined by its staff. It is our belief that this group of people will enable Kensington to achieve superior results for our shareholders.

We appreciate the guidance and support of those who helped in the formation of Kensington, including the management of Westward Energy, our two outside directors, John Gareau and Ron Quillian, the agents for our IPO, Jennings Capital Inc. and Richardson Greenshields of Canada Limited and of course our shareholders.

On behalf of the Management and the Board,

Kevin McLachlan

Kevin McLachlan
President

April 29, 1996

EXPLORATION REVIEW

Exploration Strategy

In contrast to many junior oil and gas companies, Kensington decided from the outset to pursue a strategy of exploration for new oil and gas pools using analogies to existing producing pools. While this strategy is more time consuming to implement, management believes that through new pool discoveries it will generate superior growth and increases in shareholder value. Kensington's exploration strategy includes the following elements:

- test many good exploration ideas but limit the capital risked on any one individual prospect;
- maintain a sufficient working interest in any prospect such that any success will have a meaningful impact on the Company;
- explore in areas with several producing zones to increase the chances of a discovery;
- explore for high quality reservoirs which will result in good reserve additions, high production deliverability and high netbacks.

Joint Venture Relationship

Kensington entered into a joint venture agreement with Westward Energy under which the Company is initially obligated to allow Westward to participate in drilling prospects generated by Kensington. This obligation terminates on the earlier of (i) the date on which Kensington has expended or committed for expenditure one-half of its flow-through funds raised in the IPO, and (ii) February 28,1997. As well, Westward is obligated to present to Kensington sufficient drilling prospects to allow the Company to spend one-half of its flow-through funds on such prospects.

This relationship with Westward has increased Kensington's exposure to drilling prospects and allowed the Company to participate in a more active drilling program in its early stages than would otherwise have been possible. Westward has also been the operator of most wells in which Kensington has participated.

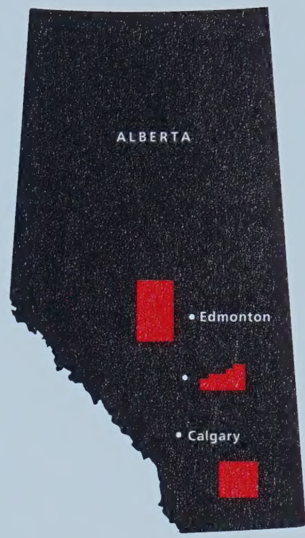
Land Holdings

At December 31, 1995, the Company held an average 31.4% working interest in 18,895 gross acres (5,941 net acres) of oil and gas leases. The geographical distribution of these leases is shown below.

Area (acres)	Gross	Net
Halkirk	5,040	1,465
Cherhill	4,800	1,872
Southern Alberta	9,055	2,604
	18,895	5,941

As at March 31, 1996, the Company's land holdings had increased to 24,807 gross acres (8,488 net acres) with an additional 14,501 acres held under option.

Kensington's land inventory has been developed as a result of an extensive effort put into prospect generation. This land base is necessary for a company such as Kensington which engages in full cycle exploration.



Kensington Exploration Areas

Drilling Activities

Kensington participated in the drilling of 11 (2.60 net) wells in 1995 resulting in two (0.10 net) oil wells, three (0.83 net) suspended oil wells and six (1.68 net) dry holes. One of the suspended oil wells produced until January, 1996 when it was shut-in due to low production rates. Two of these eleven wells were drilled on Kensington-generated prospects.

The two producing oil wells are located in the Grand Forks area of southern Alberta. One well was an extension to an existing pool while the second was a new pool discovery. After expansion of a facility to accommodate fluid production from these and other wells in the area, these two wells produced 30 barrels a day net to Kensington during the month of November. The new pool discovery well was shut-in during December and remained shut-in until early April when an application for good production practice was approved. Further drilling to delineate the size of the new pool discovery will commence once further production history from the discovery well has been established. The results from two suspended oil wells in south-central Alberta were encouraging and the Company will be doing more work in those immediate areas.

The Cherhill area of central Alberta will be the focus of Kensington's activities in the coming months. Several exploration wells are planned in this area in the summer and seismic evaluation of several other prospects in this area is ongoing. In the Halkirk area, one exploration well will be drilled this summer with seismic work continuing on several other prospects.

The Company has been encouraged by recent successful competitor drilling activity in close proximity to certain of its acreage in southern Alberta. Kensington will continue to monitor this activity.

FINANCIAL REVIEW

Financial Strategy

Kensington will initially finance its capital program with equity and cash flow. Once a production base is established, the Company will utilize some debt financing.

Financial Statements

Until commercial production is established, the Company, for accounting purposes, is in the preproduction stage. All costs, net of revenues, have been deferred and the financial statements do not include a statement of earnings or retained earnings. Once commercial production is established, the Company will apply the full cost method of accounting and statements of earnings and retained earnings will be presented.

Financing Activities

Kensington was incorporated in January, 1995 and became active in March, 1995. Prior to becoming a public company, Kensington was capitalized with $210,000 by the issuance of 1,050,000 Class A Shares to founders and directors. On August 16, 1995, Kensington closed its initial public offering of Units, raising $7,000,000 from over 700 subscribers. A total of 2,520,000 Class A Shares, 887,250 'flow-through' Class B Shares and 1,260,000 Warrants were issued. A further 736,750 Class B Shares were reserved for issue to subscribers who purchased Units on an installment basis. Subsequent to year-end, these shares were issued and the remaining $2,947,000 of proceeds from the initial public offering were released to Kensington.

The Class B Shares are convertible, at the option of the Company, at any time after June 30, 1998 and before June 30, 2000, into Class A Shares. The number of Class A Shares obtained upon conversion of each Class B Share will be equal to $4.00 divided by the greater of $1.00 and the current market price of the Class A Shares at the time of conversion. Accordingly, the conversion will result in a maximum of 6,496,000 additional Class A Shares being issued.

Each Warrant entitles the holder to acquire one Class A Share for $1.50 until June 30, 1997.

Flow-Through Share Deductions

The Company will incur and renounce to the subscribers of the Class B Shares a total of $6,496,000 of qualifying expenditures. Qualifying expenditures include Canadian exploration expenses, Canadian development expenses and Canadian oil and gas property expenses. Effective December 31, 1995, the Company renounced $1,856,162 of qualifying expenditures.

AUDITORS' REPORT

To the Shareholders of Kensington Energy Ltd.

We have audited the balance sheet of Kensington Energy Ltd. as at December 31, 1995 and the statement of cash position for the period from incorporation on January 25 to December 31, 1995. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1995 and the results of its operations and the changes in its financial position for the period then ended in accordance with generally accepted accounting principles.

Ernst & Young

Chartered Accountants

Calgary, Canada
February 28, 1996

BALANCE SHEET

As at December 31, 1995	$
ASSETS	
Current	
Cash and short term deposits	1,934,489
Accounts receivable	456,742
Subscriptions receivable [note 3]	2,947,000
	5,338,231
Property and equipment [note 2]	1,018,487
Deferred income taxes [note 3]	328,724
	6,685,442
LIABILITIES AND SHAREHOLDERS' EQUITY	
Current	
Accounts payable and accrued liabilities	524,303
Shareholders' equity	
Share capital [note 3]	3,214,139
Reserved for issue	
Class B shares [note 3]	2,947,000
Commitments [note 4]	
	6,685,442

See accompanying notes.

On behalf of the Board:

Kevin McLachlan
Director

Director

STATEMENT OF CASH POSITION

Period from Incorporation on January 25 to December 31, 1995	$
Financing Activities	
Issue of Class A Shares	714,000
Issue of Class B Shares	3,549,000
Deferred taxes	(328,724)
Share issue costs, net of deferred taxes	(418,375)
	3,515,901
Investing Activities	
Property and equipment	(1,648,973)
Changes in non-cash working capital items	67,561
	(1,581,412)
Cash and short term deposits, end of period	1,934,489

See accompanying notes.

NOTES TO FINANCIAL STATEMENTS

December 31, 1995

The Company was incorporated under the laws of the Province of Alberta by Articles of Incorporation dated January 25, 1995 with an initial share capital of one Class A common Share issued for cash consideration of $0.20. The Company's business is the acquisition of petroleum and natural gas rights and the exploration for, development and production of, crude oil and natural gas. All activity is conducted in Canada and comprises a single business segment.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared by management in accordance with generally accepted accounting principles within the framework of the significant accounting policies summarized below.

Property and Equipment

Deferred Exploration Costs

The Company's activities during the period from the date of incorporation to December 31, 1995 are related to the exploration for petroleum and natural gas. The Company is in the preproduction stage. Accordingly, all costs net of revenues, have been deferred and the financial statements do not include a statement of operations and retained earnings. The ultimate recovery of the Company's investment is dependent upon the discovery of petroleum substances in commercial quantities. These deferred exploration costs will be transferred to the full cost pool when production at commercial levels is attained and will be depleted as part of the cost of petroleum and natural gas properties.

Capitalized Costs

Once commercial production is achieved, the Company will follow the full cost method of accounting whereby all costs related to the exploration for, and the development of oil and gas reserves are initially capitalized.

Costs capitalized will include lease acquisition costs, geological and geophysical expenditures, lease rentals on non-producing properties, costs of drilling both productive and non-productive wells, equipment costs and that portion of administrative expenses applicable to these activities.

Proceeds from disposal of properties will normally be applied as a reduction of the cost of the remaining assets unless the disposal represents a significant disposition of reserves, in which case a gain or loss on disposal will be recorded.

Depreciation and Depletion

Depletion of petroleum and natural gas properties and depreciation of production equipment will be provided for using the unit-of-production method based on estimated proved petroleum and natural gas reserves as determined by independent engineers.

The depletion and depreciation cost base will include total capitalized costs, less costs of unproved properties, plus provision for future development costs of proved undeveloped reserves, as determined by independent engineers.

The relative volumes of oil and gas reserves and production will be converted at a ratio of ten thousand cubic feet of gas to one barrel of oil.

Computer equipment and furniture is carried at cost and will be depreciated over the estimated useful lives of the assets at rates of 20% to 30% calculated on a declining balance basis once commercial production is achieved.

Site Restoration

Future removal and site restoration costs for petroleum and natural gas properties will be amortized by the unit of production method.

Ceiling Test

The Company will apply an annual ceiling test to capitalized costs, net of deferred income taxes and the site restoration provision, to ensure that the net carrying value does not exceed the estimated value of future net revenues from production of proved reserves less future production related general and administrative expenses, financing costs, estimated future site restoration and abandonment costs and income taxes plus the lower of cost and estimated fair market value of unproven properties. Any reduction in value, as a result of the ceiling test, will be charged to operations.

The calculation of future net revenues will be based on wellhead prices and costs, and the income tax and Alberta royalty tax credit legislation in effect at the year end.

Flow-through Shares

The Company financed a portion of its exploration and development activities through the issue of 'flow-through' Class B Shares. Under the terms of the flow-through share issue, the tax attributes of the related expenditures are renounced to subscribers. To recognize the foregone tax benefits to the Company, the carrying value of the properties acquired and the shares issued are recorded net of the tax benefits renounced to subscribers.

Joint Interests

Substantially all of the Company's exploration and development activities are conducted jointly with others and, accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

2. PROPERTY AND EQUIPMENT

Deferred Exploration Costs	$
Petroleum and natural gas properties and equipment	1,544,679
General and administrative expenses	128,955
Tax benefits renounced	(630,486)
Interest income	(54,497)
	988,651
Computer equipment and furniture	29,836
	1,018,487

3. SHARE CAPITAL

Authorized

Unlimited number of Class A common Shares, voting, with no par value.

Unlimited number of Class B Shares, voting, with no par value.

Issued Capital

	Shares (#)	Amount ($)
Class A Shares		
Subsequent to incorporation	1,050,000	210,000
Pursuant to initial public offering	2,520,000	504,000
	3,570,000	714,000
Class B Shares		
Pursuant to initial public offering	887,250	3,549,000
Less: tax benefits relating to qualifying expenditures renounceable to subscribers	-	(630,486)
	887,250	2,918,514
Share issue costs, net of deferred taxes		(418,375)
		3,214,139
Reserved for issue	736,750	2,947,000

On March 8, 1995, the Company issued 1,000,000 Class A common Shares (the Class A Shares) to the founders at a price of $0.20 per share for proceeds of $200,000. On April 18, 1995, the Company issued 25,000 Class A Shares to each of two outside directors at a price of $0.20 per share for proceeds of $10,000.

On August 16, 1995 the Company closed its initial public offering of 7,000 units. Each $1,000 unit consists of 360 Class A Shares, 232 Class B Shares and 180 Class A Share purchase warrants. The subscription price for each unit was applied as to $72 to purchase 360 Class A Shares at $0.20 per share and as to $928 to purchase 232 Class B Shares at $4.00 per share. Subscribers were given the option of paying for their units at closing or in two installments with the final installment due January 2, 1996. A total of 2,520,000 Class A Shares and 887,250 of the Class B Shares were issued on closing of the offering.

At December 31, 1995, 736,750 Class B Shares were reserved for issue. Subsequent to year end, $2,947,000 of share subscriptions were received.

At December 31, 1995 an aggregate of 880,000 of the Class A Shares issued to the founders were held in escrow. Subsequent to the year end, 88,000 of the Class A Shares held in escrow were released pursuant to the escrow agreement. The remaining Class A Shares held in escrow will be released annually as to 18% upon each of the first, second, third, fourth and fifth anniversary from July 20, 1995.

The Class B Shares will be convertible into Class A Shares at the Company's option at any time after June 30, 1998 and before June 30, 2000. The fraction of a Class A Share obtained upon conversion of each Class B Share will be equal to $4.00 divided by the greater of $1.00 or the current market price of the Class A Shares at that time. Should

the Company fail to exercise the conversion option by June 30, 2000, the Class B Shares are convertible, at the option of the shareholder, at any time between July 1, 2000 and August 31, 2000 into Class A Shares. Any Class B Shares not converted to Class A Shares by August 31, 2000 are deemed to be converted at that time. Such conversion would result in a maximum of 6,496,000 Class A Shares being issued.

In accordance with the terms of the initial public offering and pursuant to certain provisions of the Income Tax Act (Canada), the Company is required to renounce, for income tax purposes, to the holders of the Class B Shares, $6,496,000 of exploration and development expenditures effective as of December 31, 1996. As of December 31, 1995, the Company has incurred renounceable exploration expenditures of $1,432,923. To recognize the foregone tax benefits to the Company, the carrying value of the property and equipment costs and the Class B Shares issued have been reduced by $630,486.

At December 31, 1995, 1,260,000 Class A Share purchase warrants were outstanding. Each share purchase warrant entitles the holder to acquire one Class A Share for $1.50 until June 30, 1997.

Share Options

The Company has established a stock option plan whereby up to 10% of the issued Class A Shares will be available for purchase by the directors, officers and employees of the Company. A total of 270,000 Class A Share options were granted to four employees (two of whom are also directors), two outside directors and one consultant, during the year. All of the share options vest over a three year period from the date of grant and, if unexercised, will expire on the fifth anniversary from the date of grant. Share options of 225,000 and 45,000 were granted on November 17 and November 29, 1995 respectively, at an exercise price of $1.30.

Share Issue Costs

For the period ended December 31, 1995, share issue costs of $747,099 are presented net of deferred taxes of $328,724.

4. RELATED PARTY TRANSACTIONS

The Company has entered into certain agreements with Westward Energy Ltd. (Westward), a shareholder, whereby the two companies participate in joint venture exploration and development programs. These agreements will terminate on the earlier of the date on which 50% of the flow-through funds from the Company's initial public offering have been expended or committed for expenditure, and February 28, 1997. During this period, Westward has agreed that it will offer a sufficient number of drillable prospects to allow the Company to spend 50% of the flow-through funds. In addition, the Company is obliged to offer Westward up to 60% of its interest in all drillable prospects.

CORPORATE INFORMATION

Board of Directors

Kevin McLachlan
President

Ian Collar
Vice-President, Exploration

John Gareau
President, Pentagon Energy Inc.

Ronald Quillian
President, Westrex Energy Corp.

Officers and Key Personel

Kevin McLachlan
President

Ian Collar
Vice President, Exploration

Gregory Turnbull
Secretary

Carla Carr
Corporate Administrator

Sandy Lyon
Senior Exploration Geologist

Garth Fordyce
Land Consultant

Atul Nautiyal
Geophysical Consultant

Offices

2800, 400 Third Avenue SW
Calgary, Alberta T2P 4H2

Telephone (403) 262-1701
Facsimile (403) 261-5022

Auditors

Ernst & Young
Calgary, Alberta

Bankers

Canadian Imperial Bank of Commerce
Calgary, Alberta

Registrar and Transfer Agent

Montreal Trust Company of Canada
Calgary, Alberta

Solicitors

Code Hunter Wittmann
Calgary, Alberta

Stock Exchange Listing

The Alberta Stock Exchange
Trading Symbols
Class A Shares: KNN.A
Class B Shares: KNN.B
Warrants: KNN.WT.A

Kensington Energy Ltd.

2800, 400 Third Avenue SW, Calgary, Alberta T2P 4H2
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